

Tax Office rights of recovery on relationship breakdowns

by Matthew Burgess, Director, View Legal

The ability of the Family Court to divide the assets owned personally by a couple - including via superannuation - on a relationship breakdown is largely without question.

In contrast, the exposure of assets owned via (for example) a trust have been, and indeed arguably remain), subject to conjecture.

Another area that, at least historically, was potentially uncertain, was the ability of the Family Court to allocate responsibility for payment of the tax debts of either spouse.

Responsibility for tax debts

The High Court decision in *Commissioner of Taxation v Tomaras & Ors* [2018] HCA 62 (“Tomaras”), confirmed that tax debts can be apportioned by the courts on a relationship breakdown.

In *Tomaras*, the wife had failed to pay tax amounts assessed to her and was out of time to challenge the assessments. Furthermore, the husband had been declared bankrupt.

As part of the property settlement proceedings, the wife sought an order that the husband be substituted for her as the debtor liable to the Tax Office.

In holding that the husband could be substituted for the wife in relation to the tax debt, the court also confirmed that this may not always be appropriate. In particular, the court would need to be satisfied that:

- the making of the order is reasonably necessary or appropriate to achieve a division of property between the parties to the marriage;
- it is foreseeable that the debt will be paid in full; and
- it is just and equitable in the circumstances.

Therefore, in Tomaras, given the husband was bankrupt and the ability to challenge the assessments had lapsed, the court did not in fact exercise its powers to make the husband liable for the tax debt.

Recent decision

In the case of Cao & Trong [2022] FedCFamC1F 754 (“Cao”), the powers of the family court in relation to tax debts were further explored.

Relevantly in Cao, allocation of an amount in the region of \$3.1M was in dispute between the former spouses, the Tax Office and the Child Support Register.

The Tax Office was owed more than \$7M in unpaid tax and was held by the court to be entitled to 100% of the disputed amount.

The court specifically confirmed:

- It is for the court to determine what is a 'just outcome' - which often demands that an aggrieved spouse 'take the good with the bad'; that is, the benefits indirectly gained by a spouse in having the pool of assets increased as a result of the availability of funds which would otherwise have been paid out in tax may in turn mean the spouse will be less entitled than the Tax Office (see Johnson v Johnson [1999] FamCA 369).
- While no spouse has an automatic entitlement to funds, the benefit each party has received from funds is a highly significant consideration when addressing the position of an unsecured creditor (relevantly here, the Tax Office) whose prospects of recovery of the debt are uncertain (see Commissioner of Taxation v Worsnop (2009) 40 Fam LR 552)
- A creditor who becomes a party to family law proceedings does not, on the basis of justice and equity, improve their position as compared to what they would have enjoyed had the creditor pursued the spouse-debtor alone.
- This said, where the Tax Office is a creditor of taxpayers it is critical to understand that the onus is on taxpayers to make full and proper disclosure - the Tax Office does not extend credit at all, but rather becomes a creditor by virtue of the conduct of the affairs of the taxpayer.
- A spouse may have priority to the Tax Office where there are 'compelling circumstances' supporting this - of which there were none in this case.
- Ultimately, a very relevant consideration for the court will be whether the parties to a marriage have enjoyed the benefit of the use of money on which a substantial liability for tax has not been discharged by payment - as was the case here.

Conclusion

Interestingly, the court in Cao declined to specifically address whether it has a duty to protect the revenue in family law cases - despite the following statement by the barrister for the wife “you [an impolite reference to ... the judge] are not under a duty to protect the revenue”.

Instead, the court confirmed that the parties had enjoyed an opulent lifestyle at a time when the debt due to the Tax Office - that is the lifestyle that the husband and the wife enjoyed was in fact enjoyed by them mainly by reason of their failure to discharge the indebtedness to the Tax Office.

The court further confirmed it would be incongruous for it to take into account non-financial contributions to the marriage by the wife while concurrently relieving her of any liability for the tax debt.

Cao is a timely reminder that the Tax Office will intervene in family law disputes to protect the revenue due to the Commonwealth, and that the courts will actively ensure the rights of the Tax Office are protected – and enforced.

